

**Remarks of
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Federal Energy Regulatory Commission**

***LESSONS THE COLLABORATIVE PROCESS HAS TAUGHT:
SPEECH ON ORDER NO. 2000 AND RTO ISSUES***

**LOUISIANA STATE UNIVERSITY
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Your invitation turned out to be very timely for me to speak about Order No. 2000 and RTO issues. FERC just finished its first round of collaborations last week, with the meeting on the Southeast held in Atlanta. Before that, the staff ran meetings dealing with the Midwest, Northeast, Northwest and Southwest.

When FERC issued Order No. 2000, we tried a new approach to regulation. We identified a problem – inefficient electric markets. We found a strategic solution – regional transmission organizations. And then, rather than write rules, we set the goals of RTO's: stand-alone businesses that take charge of the grid. We stopped there: We substituted incentives and flexibility for the usual "shall" or "must." By incentives we mean rate moratoria, formula rates of return, incremental pricing and shorter depreciation for new construction, performance-based rates (internal or external measures) and anything else that meets the standard of need and promotion of efficiency.

We said to the industry, "We showed you the destination, now you take us there." I thought that the fact Order No. 2000 calls for a stand-alone business, and especially the incentives that put profit into it, would bring forth transco's. However, I could not assume that would be the case, because of the inertia behind the status quo and politics of stake holders and certain state commissions that want to keep their turf intact. For that reason, I agreed to the collaboration that FERC launched, but I also wondered whether the participants could speak their minds freely.

In order to better facilitate open and frank discussions, I honored the Chairman's request not to attend the collaboratives. Now that the first round has ended, I have very good news to report, especially from this region, the Southeast. Order No. 2000 does point toward transco's. Here, in the very region that the so-called experts expected the most resistance to Order No. 2000, the participants most embraced it. Florida Power & Light Company, Entergy, Carolina Power & Light, Duke Power Company and the Southern Companies promoted the for-profit transco, to varying degrees because of the opportunities the incentives of Order No. 2000 created.

That alone makes my free-market face smile. But, as the saying goes, "you ain't seen nothing yet."

The Tennessee Valley Authority, the much-maligned bureaucratic TVA, jumped on the transco bandwagon! Another friend from Mississippi, and new director at TVA, Glenn McCullough, is already making a difference. In the Northwest, the investor-owned utilities preferred a transco, and, again, so did the Bonneville Power Administration, the much-maligned BPA. Our deadlines may make the Northwestern parties go for less than a transco at the outset and Congress needs to legislate to allow BPA, that owns 80% of the transmission out there, to sell or turn over its system to an RTO.

The Midwest is a battleground still, but we have made great progress. In 1998, when we approved the Midwest ISO, people thought it would keep everything to itself and act as the Master of the Grid, now the ISO must share with for-profit transco's within its membership. When FERC approved the so-called binary arrangement in February, we, in fact, vetoed the idea of ISO die-hards, that the ISO must have supreme authority and the transco's the subordinate. We will entertain any sort of rational division. We do not need more bureaucracy, we need less. The Midwest has a pure transco trying to form, the Alliance. Someone said when we approved the Midwest ISO that he feared that people would think our action the "high water mark" for ISO's. He got it half right. We now KNOW it was.

In the Northeast, New England has within it the National Grid Company, the owner of the New England Electric System. National Grid's parent operates the transco of England and Wales. In the collaborative meeting, NEES advocated a transco for New England. Even in California, Order No. 2000, I predict, will spur reform within the ISO. I predict members of the ISO's will leave for higher ground. The Southwest has just begun to consider these matters. Surprisingly to some people, public power there, in particular in Nebraska, is undertaking a transco.

For the rest of my address, I will talk about two issues for transco's and two for ISO's. I consider solvable those of the transco's, those of the ISO's present insuperable obstacles. Those of the transco's involve independence and scope. On independence, a transco can use passive ownership. In fact, Order No. 2000 made passive ownership easy, as long as it remains the financial variety. Order No. 2000 said that passive ownership arrangement should fulfill filing requirements on fiduciary duty, degree of control over operation (none and none) and access to capital independent of passive owners (complete).

Scope is more difficult. Regulators think in terms of geography, businessmen in terms of the market. We should start thinking in terms of a market, because that is what Order No. 2000 envisions. Combining states for its own sake reflects geography. Transco's must reflect the market. For a transco, then, FERC should ask the company to show: the population density of its territory, the location of generation and interconnections, the trading pattern in electricity— current and future -- as well as complete energy coverage. If we ask these questions, transco's can show proper scope. Businesses must have proper "scope" to succeed. Transco's are businesses.

We need to give transco's time to grow, lest we have what appears in the Northwest, the pressure to get anything leads to second-best decisions. As I said earlier in regard to the Northwest, I worry that the pressure to "get anything in" will lead to bad decisions. "Act in haste and repent at leisure." Fortunately, Order No. 2000 allows filing parties to describe further steps they need to take to form RTO's.

The insuperable issues for ISO's, to me, revolve around independence and operations. FERC will audit independence of ISO boards, without having laid out what kind of board will satisfy the audit. We don't know what an independent ISO board is, because, so far, none -- stakeholder and outside -- has shown promise.

As to operations, section 205 rights and the requirement to order construction present problems for ISO's. Owners will want to retain their section 205 filing authority and will not want their financial future determined by filings made by the ISO. Order No. 2000 allows owners in ISO's, at most, to establish their revenue target. How the owners will collect it the RTO Rule left open, except to say that the ISO will design the rates.

Transco's will be the answer for the electric industry that will allow entrepreneurs to build out and invest in a transmission system that is capable of handling competitive loads reliably. Whereas Order No. 2000 has moved us in the right direction, we must look further into our energy policy, to be more cognizant of current impediments to competition and choice.

It is important that we have a consistent energy policy that provides balance, environmentally while giving competitive choices. We must think across product lines and move away from categories.

The Administration tends to think about reliability as mandatory reserve requirements and rules of priority on the system. I think about reliability as part of efficient operation of businesses in the market. The majority at FERC shows a fondness for price controls – price caps – on energy markets during extremely hot or cold weather.

Price caps reduce reliability by restricting investment and making it easier to avoid reform.

On oil and gas exploration and production, we need to look at current and future leases on a case-by-case basis.

This country can increase reliability in electricity by encouraging pipelines in the Northeast to expand. Natural gas fuels generators and forms a substitute for electricity. We talk a lot about a 30 TcF markets by 2010, but, in fact, FERC acts as if we are awash in cheap oil. We delay certification because of landowner concerns, when the "landowners" have property 50 miles away. While paying lip service to the market, we ignore its basic premise – entrepreneurs sink or swim based on their judgment on demand. We need to see contracts, and, in some cases, look behind the contracts to see how "legitimate" the transactions are.

The old way of regulation – that thinks of cost recovery as the road to consumer protection and disdains profits as exploitation must give way in the new Millennium. The old way guarantees utilities recovery of high costs; the new way lets transco's earn more if they reduce costs. Which way leaves us, the customers, better off in the end? Which policy induces innovation and increases supply? Which policy saves customers money? I leave it to you.

Fundamentally, we must refocus our mind on the fact that "profit", far from being a dirty word, made this country great. RTO's, like other businesses, exist to earn profits, not to recover costs. If we yoke the public interest to the private interest of business, we will all win in the end. Finally, we must adopt a consistent policy. If we want RTO's to take risks, we must allow them to reap rewards. If rates fall, let profits go up. We must also understand that, whatever we do in gas, oil, hydroelectricity and transmission has an effect on the whole energy arena, and, ultimately, on our quality of life.

Thank you.